

PALESTINE MONETARY AUTHORITY

FINAL REPORT

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I. EXECUTIVE SUMMARY (Project's History)

This report summarizes the assistance of Barents Group of BearingPoint (formerly KPMG Consulting) to the Supervision Department of the Palestine Monetary Authority (PMA), as contracted and funded by the United States Agency for International Development (USAID). USAID, through Barents Group, has provided assistance to the PMA since February 1999. The primary goal of this assistance can be best summarized as supporting the PMA in developing, modernizing and strengthening key bank supervision processes and in introducing a financial intelligence unit (FIU). The objectives of this assistance have been to provide support in the following areas:

- Organizational Structure and Policy
- On-site Supervision
- Off-site Supervision
- Legal and Regulatory
- Problem Bank Supervision
- Licensing
- Training
- Financial Intelligence Unit

USAID advisors have effectively assisted the PMA in its efforts to develop, modernize and strengthen key bank supervision processes despite the outbreak of the second Intifada, on September 28, 2000. The outbreak of hostilities severely limited USAID advisors' access to the PMA and curtailed freedom of movement for the PMA staff. In addition, the high level of turnover of middle management at the PMA put additional pressure on USAID advisors, who needed to gain the acceptance of four different managers of the supervision department over a four and one-half year period.

The success of the project is due, in large part, to the support USAID advisors received from Governor Dr. Amin Haddad of the PMA and the consistent, committed and supportive attitude of our partners at the USAID. Furthermore, these accomplishments would not have been possible without the cooperation and dedication of our counterparts at the PMA supervision department, who managed to participate, learn and develop new tools despite the considerable hardship and stress experienced during the Intifada.

Since the beginning of the project, the supervision department at the PMA increased its staff by 60%. These newly hired employees were trained and integrated into the department.

Examiners, analysts and coordinators formed the Offsite Methodology Development Committee, and the Regulatory and Legal Review Committee. These committees became conduits for developing new supervisory tools and for intensive on-the-job training in supervisory techniques.

Although much remains to be accomplished, after four and one-half years of assistance the PMA performs its duties in a more consistent and efficient manner. The following highlights some of the most significant tangible successes achieved by the Barents Group team during this project:

- Provided extensive assistance in the development of a Bank Supervision Strategy for 2002. Advisors worked closely with the supervision staff to design the format, communicate expectations and provide direct input into the development of six primary goals: Supervisory File Development; Quality Control Program; On-site Manual Implementation; Call Report Implementation; Manual for Operations Implementation; and, Establishment of the Technical Support Unit.
- Developed an On-site Examination Manual based on the U.S. regulatory system, but customized to suit the Palestinian banking and supervisory environment. Sixteen chapters of the On-site Examination Manual were drafted during USAID assistance to the PMA. Examiners and PMA managers conducted extensive testing and review of eleven chapters, providing valuable insight to specific issues relevant to the Palestinian banking industry and appropriate financial terminology for the Arabic translation.
- Developed a risk rating process based on the CAMELS rating system, setting a foundation for a risk-based supervisory approach at the PMA.
- Designed a new Report of Condition and Income together with detailed line item instructions, assisted the PMA staff during the introduction of the new report to the banks, and supported the PMA and the banks throughout the implementation process.
- Developed programming instructions and a users' guide for the Uniform Bank Performance Report (UBPR) and supported the PMA during the development of this supervisory tool.
- Introduced CAEL risk rating system and trained PMA analysts in its application in the off-site supervisory surveillance process.
- Assisted the PMA in the preparation of regulations concerning Provisions and Collateral for Facilities; Credit Concentrations and Investments; Capital Adequacy Ratios and Minimal Capital Requirements; Open Currency Positions; Liquidity Requirements; and, Investment Securities and Bank Dealer Activities.
- Reviewed a draft of the Banking Law from the point of view of the enforcement capability of the PMA.
- Prepared a problem bank manual and conducted workshops in order to build infrastructure for dealing with problem banks.
- Prepared a comprehensive bank license approval package and provided guidance on the treatment of Money Changers by the supervision department.
- Delivered fourteen formal courses to the PMA staff and conducted numerous on-the-job training sessions.
- Assessed the organizational, financial and legislative environment as it relates to the introduction of a financial intelligence unit (FIU).

II. PROGRESS RELATIVE TO TANGIBLE RESULTS

The Tangible Results for this program can be grouped into eight categories: Organizational Structure and Policy; Onsite Supervision; Offsite supervision; Legal and Regulatory; Problem Bank Supervision; Licensing; Training; and, Financial Intelligence Unit.

A. ORGANIZATIONAL STRUCTURE AND POLICY

In an effort to provide more guidance to the management and staff of the PMA Bank Supervision Department, USAID advisors provided recommendations and assisted in refining the department's organizational structure. Additionally, USAID advisors reviewed and made recommendations on certain functions and policies that enhanced the PMA's effectiveness. The USAID advisors' initial efforts focused on developing a comprehensive Strategic Plan. Although PMA management did not adopt the recommended plan, many concepts detailed in the plan were used in the development of a Manual of Operations and the Strategy for 2002. USAID advisors provided research, assistance and recommendations concerning the development of an Outreach Program, Cross-border Agreements and dealings with External Auditors.

The efforts of the PMA and USAID advisors in the areas of: Strategic Plans; Manual of Operations; Strategy for 2002; Outreach Program; Cross-Border Agreements; and External Auditors are detailed below.

Strategic Plan

USAID advisors worked extensively on a strategic plan for bank supervision during 1999. The draft plan identified benchmarks for the Supervision Department with assigned timeframes. The final draft strategic plan for Bank Supervision included a mission statement accompanied by specific components necessary within Bank Supervision in order to reach each goal. Unfortunately, the Governor at the time left the PMA without approving the final strategic plan. While the strategic plan was never officially adopted, many of the concepts were incorporated in the Manual for Operations.

Manual for Operations

In June 2000, USAID advisors began assisting the Deputy Governor with the development of a Manual for Operations for the Bank Supervision Department. This manual restructured the department with a new organizational chart and established systems for each of the divisions of Bank Supervision. The Manual for Operations' developmental process provided USAID advisors with an opportunity to present integrated supervisory concepts and strengthen the concept of scheduling bank examinations based on a bank-specific supervisory strategy (risk-based approach).

The design of the manual started with a draft prepared by USAID advisors. The manual outlines the mission, objectives, and responsibilities of the Bank Supervision Department as a whole, the Supervision Department Council and each unit of the department. In addition, it contains detailed descriptions of each professional job in the department, including job summaries, responsibilities, and requirements. It further provides detailed descriptions of lines of authority and communication. The

manual received extensive review by the PMA management and staff throughout the remainder of 2000 and the first six months of 2001.

In mid 2001, Acting Governor Dr. Amin Haddad approved the manual for operations as an official guideline for operations of the Supervision Department. USAID advisors met with the supervision staff on several occasions to provide training on the manual and to reinforce concepts of integrated supervision.

Strategies for 2002 and 2003

At the request of Governor Haddad, USAID advisors guided the PMA staff in developing Bank Supervision Strategies for 2002 and 2003. Advisors assisted in selecting team members, designing the format, communicating expectations, reviewing draft products, and providing direct input into the plan. Advisors first guided the staff in developing six primary goal statements, identifying the steps to accomplish the goals, and developing an action plan to implement the steps. For the 2002 strategy, the six primary goal statements were: Supervisory File Development, Quality Control Program, On-site Manual Implementation, Call Report Implementation, Manual for Operations Implementation, and Establishment of the Technical Support Unit.

The PMA Bank Supervision Staff vigorously implemented the strategic plan in January 2002, but their work was severely disrupted by the accelerated violence in the West Bank during this period.

Upon his arrival in late 2002, the senior consultant assisted in the development of the strategic plan for 2003. Again, six objectives were identified: encouragement of the reduction of the number of financial institutions; increased communications between the PMA and external auditors; enhancement of the technical skills of banking supervision department managers and staff; development and implementation of a program for dealing with problem banking institutions; completion of an assessment of all banks' risk management practices, including adherence to the banking law and PMA circulars and orders; and, improvement of department structure and reporting documentation. Because of a change in department management and the March 2003 ordered evacuation, the plan was never submitted to, or approved by, the PMA Board of Directors. However, the department has made efforts toward implementing all of the objectives.

Outreach Program

To determine the need and extent of a formalized outreach program, USAID advisors met with several commercial bankers, as well as representatives of the accounting community to determine the concerns they faced in their dealings with the PMA. From these meetings, USAID advisors identified a need for a more comprehensive approach to standard communication activities with the banking and financial community. Although the PMA management rejected the recommendation for a formal outreach program, the PMA staff along with USAID advisors began to consult with banks on issues, such as new regulations, regulatory reporting, management information systems, and information technology. During the last quarter of 2001, the PMA increased considerably the frequency and scope of outreach activities because of the new Call Report implementation.

During the last quarter of 2002 and the first quarter of 2003, the resident advisor participated in meetings between the PMA Offsite unit and individual bank managers. The purpose of these meetings was to discuss problems associated with completion of the newly adopted Call Report. What was also gained from the meetings was an opportunity for bankers and PMA staff to meet and discuss common areas. This resulted in an increased understanding on the part of both towards the other. During this time period, the resident advisor also met with the Palestinian Bankers Association to discuss common concerns – mainly provision requirements.

Cross-Border Agreements

Initial work on a cross-border policy began in May 1999, when USAID advisors identified weaknesses in current cross-border agreements with the countries of Jordan, Egypt and Tunisia. USAID advisors prepared a revised cross-border supervisory agreement with the Central Bank of Jordan. The revised agreement incorporated the Basle Committee's policy on cross-border supervision and international regulatory standards.

External Auditors

At the request of the PMA, USAID advisors researched ways that the PMA can deal effectively and equitably with external auditors. The research involved reviews of the United Kingdom's Financial Services and Markets Act, material from the United Kingdom's Financial Services Agency and the International Federation of Accountants. The PMA wants to ensure that external auditors provide more reliable and thorough audits using qualified auditors and based on International Audit Standards. This initiative will potentially require changes in current laws and regulations, and closer cooperation between the PMA, banks, accounting firms and associations.

In early 2003, the resident advisor assisted department staff in the development and delivery of a conference for External Auditors. It was the first such meeting. More are planned and are scheduled on a quarterly basis.

B. ON-SITE SUPERVISION

The purpose of this element of technical assistance is to assist the PMA in building a well-trained, consistent, risk-focused examination workforce. This element is comprised of three primary areas: 1) develop basic chapters of an On-site Supervision Manual (hereinafter, "Manual"); 2) develop other tools and policies to increase the efficiency and consistency of the on-site examination process; and 3) deliver formal and on-the-job training in risk-based supervision and the use of the Manual.

On-site Examination Manual

Initial efforts focused on developing a Manual that addressed the basic risk factors inherent in any banking system and further tailored the Manual to address specific risk issues relevant to the Palestinian banking industry. Expectations at the beginning of the project were to build an on-site manual based on existing PMA manuals. However, the PMA had no functional on-site process, and thus no existing on-site supervisory tools. Thus, on May 3, 1999, Governor Foad Beseiso requested that

USAID advisors develop a manual based on the U.S. regulatory system. Sixteen chapters of the On-Site Examination Manual were drafted during USAID assistance to the PMA. Examiners and PMA managers conducted extensive testing and reviews of eleven chapters, providing valuable insight to specific issues relevant to the Palestinian banking industry and appropriate Arabic translation. USAID Advisors and PMA staff assembled the eleven chapters into a final publishable format and presented the Manual for approval to Acting Governor, Dr. Amin Haddad, on March 15, 2002.

Much of the difficulty in accepting and using the Manual stemmed from the complexity of the Arabic language. Many of the terms used in the Arabic version were in dispute because of the lack of a commonly used banking language in the West Bank and Gaza. Bankers and regulators in the West Bank and Gaza gained their education and experience in various “language regions” of the Arab world, and thus prefer to use the Arabic terms that are most familiar to them. This difficulty will not go away until the Palestinian banking industry and the PMA develop a glossary of Palestinian Arabic banking terms.

Despite the lack of complete acceptance and approval by PMA senior management, USAID advisors used the draft manual as the foundation for their training and guidance during examinations. This demonstrated to the PMA staff the benefits of the manual as a guide to the examination process and its value as a rich resource in understanding and analyzing risks. Because of these benefits, the PMA staff provided considerable effort and input in making the Manual a credible and useful tool in the examination process.

While USAID advisors have developed 16 chapters for the Manual, only eleven have been adopted because of the necessary extensive testing and revising (specifically in the use of the Arabic language). The Arabic version of the remaining five chapters have been reviewed and revised, taking into consideration the recommendations provided in the testing of the initial eleven chapters. These remaining five chapters will require testing by the PMA staff and management. The finalized eleven chapters cover the following topics:

Planning and Control for Supervisory Activities, Internal and External Audits, Review of Regulatory Reports, Analytical Review of Income and Expenses (Earnings), Capital Accounts and Dividends (Capital), Deposit Accounts, Funds Management (Liquidity), Management and Board Processes (Management), Letters of Credit (Assets), Commercial Loans (Assets), and Guaranties Issued.

The five chapters yet to be tested and adopted cover the following topics:

Loan Portfolio Management, Computer Services, Foreign Exchange, Related Organizations, and Overall Conclusions Regarding the Condition of the Bank.

During the spring of 2003, the senior consultant assisted in the departments’ chapter-by-chapter review. During these reviews a senior member of the department presented the contents of each chapter. Discussion was then held on the meaning of

terms. The senior consultant would then answer questions regarding examination procedures listed in each chapter.

Supervisory Tools Related to On-site Supervision

As in any approach that requires objectivity and consistency, there is a great need to employ standard tools and sound policies. USAID advisors developed a number of such tools and policies to educate examiners and assist them in the examination process. These tools focused on a risk-based approach to supervision and emphasized the need to identify root causes of deficiencies and high-risk activities. This was a major shift from the PMA's earlier approach of determining compliance with laws and regulations, rather than actually identifying and measuring risks. The tools were also designed to assist in the examination process and allow examiners to take a consistent approach towards examining banks. Throughout the project, the tools have been revised and enhanced to reflect the changes in the Palestinian banking industry and the supervisory needs of the PMA.

These tools included:

- 1) A risk rating process based on the CAMELS rating system which provides the fundamentals necessary to accurately rate the risks in six categories: Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk. A matrix was drafted and discussed with senior department personnel. The result of these discussions was the adoption of the matrix to the banking situation in the West Bank and Gaza. Recently hired staff were given instruction in the use of the matrix; however, at the end of the contract, the matrix had not been officially adopted for use by the department.
- 2) A standard format for Reports of Examinations that, at a minimum, covers the major risk areas analyzed during an examination.
- 3) A standard request letter for on-site examinations which sets forth the items needed by the PMA from the bank in order to accomplish the on-site examination.
- 4) A Supervisory File for each bank consisting of a computer-based data file containing corporate and risk assessment information, including summaries of on-site inspections and off-site analysis, correspondence, and supervisory action plans for each bank.
- 5) Supervisory action plans which act as the basis for a formalized scheduling process for on-site and off-site activities.
- 6) A checklist of suspicious activities that would aid the examiners to recognize fraudulent activities as they perform their regular examination duties. The checklist covers activities that may occur in the course of money laundering, check kiting, embezzlement, and other incidents of fraud.

Training

USAID advisors provided considerable training in the use of the Manual and examination tools through formal and on-the-job training.¹ Formal training centered on basic risk-based issues using as its foundation the CAMELS rating system. In addition, training opportunities were used to emphasize the need for integrated on-site and off-site supervision.

During the project, a considerable amount of on-the-job training was provided. However, USAID advisors found it difficult to provide effective and thorough on-the-job training because they were not initially allowed to accompany on-site inspectors to examinations. Thus, the most effective on-the-job training was provided during the planning stage of on-site examinations and the preparation of Reports of Examinations, which were routinely carried out at the PMA office. In an attempt to deliver on-the-job training during an examination, examiners met daily with USAID advisors at the PMA office to discuss issues arising during the day. Additionally, USAID advisors were in frequent contact with examiners via the telephone and, at times, email. While this proved beneficial, this method of on-the-job training slowed the learning process and prevented full development of examiner skills.

C. OFF-SITE SUPERVISION

In order to strengthen the PMA's off-site capacity, USAID advisors concentrated their efforts on the following components: Introduction of the Report of Condition and Income, Development of the Uniform Bank Performance Report, Strengthening the Capacity of the Off-site Supervision Unit, Implementation of the Report of Condition and Income, and Introduction of Supervisory Tools Related to Off-site Supervision.

Introduction of Report of Condition and Income

The initial stage of the off-site supervision component focused on accounting and regulatory reporting issues. USAID advisors conducted a review of the PMA's bank reporting forms and instructions. This diagnostic resulted in the recommendation to enlarge the scope of the regulatory reporting in order to create the basis for a more comprehensive financial condition analysis and risk assessment of a single bank. The recommendations also included the design of several supporting schedules and reports ensuring that the PMA collects data elements necessary to calculate capital, asset quality, earnings and liquidity ratios, thus constituting the basis for financial condition analysis and risk assessment and the development of a comprehensive set of instructions ensuring data integrity and comparability.

In addition, USAID advisors proposed to transfer the database maintenance at the PMA from a PC to a server environment. In order to facilitate these changes USAID advisors suggested the formation of an off-site methodology development team responsible for the design of the new Report of Condition and Income, its

¹ Please see the section of this report on training for a comprehensive listing of all formal training courses delivered during the project.

instructions, implementation of the report at the banks and establishment of the PMA supervisory database.

USAID advisors transferred an existing single bank's data to the Barents office in Washington DC in order to design a link between the data and an analytical system called Bank Off-site Supervision System (BOSS) and to produce intermittent reports for the PMA. The BOSS was selected because it was previously successfully introduced in a banking system comparable in size to the Palestinian banking system. The Barents programmers completed a preliminary design of BOSS for Palestine and USAID advisors presented it to the PMA. However, PMA management decided to return to the original plan of internal design of the supervisory database and a representative of the PMA Information Technology Department was incorporated into the activities of the off-site methodology development team.

The English and Arabic versions of the Report of Condition and Income were completed during the first quarter of the year 2000 and the off-site methodology development team began to circulate the Call Report for review and comments among the supervision staff both in Ramallah and Gaza offices. Simultaneously, USAID advisors and team members initiated outreach efforts to the banks and began to visit individual banks in order to discuss the proposed supervisory reporting and obtain the feedback about banks' ability to generate the required information.

During the second and third quarter of the year 2000, the PMA staff continued to review the proposed Report of Condition and Income. This review became an integral part of the on-the-job training process for the supervision staff focusing on regulatory issues related to the new reporting requirements. These included loan classification, provisions for loan losses, legally admissible collateral, balance sheet valuation process and its income statement recognition, accrual basis of accounting and the calculation of Capital Adequacy Ratios. In addition, teams reviewed the Arabic translation of the line item instructions to ensure uniformity and clarity of the financial and regulatory terminology of this version.

Simultaneously, an IMF Mission conducted a review of the newly proposed Call Report and asked for modifications that would incorporate the balance of payment requirements. USAID advisors supported the PMA staff in designing appropriate modifications in an effort to combine all the reporting requirements of the PMA, thus reducing regulatory burden to the banks.

Development of the Uniform Bank Performance Report

The off-site development efforts focused on the design and testing of the interface module to facilitate transmission of data from the banks, data base building to contain the newly gathered data, and programming and testing of the supervisory analytical output reports, Uniform Bank Performance Report (UBPR).

During the first quarter of 2001, USAID advisors completed programming instructions for the UBPR and designed a Users' Guide for the report. The UBPR is an analytical tool created for off-site analysis and for the preparation of on-site examinations. In a standardized format, it illustrates the impact of management

decisions and economic conditions on bank performance and balance sheet composition. The performance and composition data contained in the report is used to evaluate adequacy of capital, earnings, liquidity, asset and liability management and growth management.

The UBPR is based on the information collected from the banks and housed at the PMA database. The report contains over 500 values and financial ratios designed and presented in a way that provides a comprehensive view of a bank's financial performance. The UBPR usually contains peer group data facilitating comparative analysis of banks. Initially, the Palestinian UBPR will concentrate on analysis of a single bank and the selection of peer groups will be attempted after several quarters of data are gathered and analyzed.

The UBPR presents bank ratios across various time bands allowing analysts to observe trends and changes in banks' financial condition. On the basis of the UBPR methodology, analysts are able to review a bank's present financial condition and make predictions about future trends. The tool is also useful during on-site examinations in an examiner's review of earnings performance.

Near the end of the contract period, the senior consultant was working with the department in extracting key ratios from the report that would then be used as part of an Early Warning System. This would compare individual bank performance in the areas selected against adopted norms. Deviations from these norms would alert the department to potential problems. The department would immediately focus on these areas of alert – thus, an Early Warning System would be in place. As stated above, efforts in this area were begun at the end of the contract period and were not completed.

Since the PMA opted for the internal development of database and output reports, the IT department hired two designated programmers who completed the development of an Oracle database, an Excel interface module and the UBPR output reports during the second quarter of 2001. The programmers also began to test the UBPR formulas on the test bank program prepared by USAID advisors before the real life data became available.

Strengthening the Capacity of the Off-site Supervision Unit

During the first quarter of 2001, at the request of Dr. Amin Haddad, the off-site development efforts turned to strengthening the capacity of the off-site supervision unit. Throughout the duration of the technical assistance, the unit has experienced a very substantial staff and line management turnover, seriously impeding the efforts to institute appropriate guidelines and procedures. USAID advisors supported the off-site unit in instituting procedures and reports tracking banks' non-compliance with normalized ratios and maintaining appropriate contacts with banks' management.

A major effort was made to strengthen the monitoring of the quality of banks' financial reporting to the PMA, instituting an initial review by an analyst of monthly reports, communicating errors and inconsistencies to the banks and a follow up process, in order to obtain corrected information from the banks. The initial review

of the regulatory reporting includes internal consistency checks for all reports and supporting documents as of the same reporting date, comparison of reports for several consecutive periods and, whenever possible, comparison of the PMA data with data included in the external auditors' reports. For the purpose of this review, USAID advisors designed several Excel spreadsheets and incorporated them into the on-going monitoring of the quality of the regulatory data.

In addition, the analysts are required to maintain up-to-date files of all banks supervised by the off-site unit in Ramallah, containing results of financial analysis together with appropriate work papers, correspondence with the bank, recommendations and records of supervisory actions and the latest on-site examination report.

A transfer of the supervisory data maintenance from a PC to a server environment requires ongoing cooperation between the off-site supervision unit and the IT department. USAID advisors worked with both entities to establish closer cooperation and put in place procedures for data gathering, validation and access.

Implementation of the Report of Condition and Income

The Report of Condition and Income was distributed to the Palestinian banking system on February 25, 2001. PMA management required banks to review the new reports and submit their comments to the PMA by the end of March 2001. In order to provide support to the banks in the new Call Report implementation process, the PMA organized a series of outreach sessions and invited banks' representatives to discuss issues and timeframes related to the new report implementation. USAID advisors provided ongoing support in preparation of outreach efforts and participated in all meetings organized by the PMA.

The first outreach meeting was held in April 2001. USAID advisors delivered a presentation outlining the differences between the new and the existing reporting systems. Dr. Jemal Nouh, the head of the IT department, presented the IT department plan to support the banks in the implementation of the new reporting. The second outreach meeting was held in May 2001. Representatives of the banks met with the PMA staff and USAID advisors to discuss Report of Condition and Income implementation issues. As a result of these meetings, the PMA was able to gain an appreciation of the banks' perspective on cost and time estimates for the new report implementation. In addition, the PMA staff continued to educate banks' representatives on requirements of the new reporting, discussing a wide range of accounting, systems and operational topics.

In order to help banks in the new reports' implementation process, the PMA proposed to utilize the banking network, developed for the payment system, to assist banks in linking their branches with their headquarters. Such a link should improve banks' ability to produce timely and correct financial statements, thus positively affecting the supervisory reporting.

During the third and fourth quarter of 2001, the PMA staff intensified outreach efforts related to the new reporting implementation by conducting follow up visits to the

individual banks and by providing guidance to computer companies retained by banks to amend their systems. USAID advisors participated in these visits, reviewed follow-up reports and supported the PMA in preparing communications to the banks regarding sequencing of the accounting and systems' changes required for the implementation of the new reporting.

Banks' representatives visited the PMA in November 2001 in order to discuss the progress of the new regulatory reporting efforts. A majority of banks informed the PMA that the difficulties they encountered during the Call Report implementation might prevent them from meeting a January 11, 2002, deadline. A meeting was held during intensified closures imposed on towns and villages in the Palestinian Territories and banks' staff had experienced frequent difficulties and delays in reaching their offices. In addition, two foreign branches planning to implement new computer systems in order to facilitate the new reports' implementation, experienced difficulties in bringing IT teams from Jordan to Palestine.

The PMA invited general managers of banks and informed them that they had no intention of extending the Call Report submission deadline any further. General managers assured the PMA of the continuous efforts by the banks to implement the new reporting system and promised to finalize the accounting and system changes during the first quarter 2002. The PMA informed the banks that they are required to submit a parallel reporting during the first quarter of 2002 and they would continue to file both sets of reports until the PMA is satisfied with the quality of the new reports.

During the first quarter of 2002, the majority of the Palestinian banks submitted the new reports at the PMA. The quality of the completeness of these reports varied greatly, and is directly related to the complexity of each institution as well as to the level of IT systems and the ability of bank's staff to understand and apply the International Accounting Standards.

The PMA staff and USAID advisors conducted extensive reviews of the new reports, including analysis of internal consistency, comparison with the existing reports for the same period and comparison of the new reports for consecutive periods. The results of these reviews were communicated to the banks and banks' representatives promised to correct data and resubmit the reports at the PMA, as well as to continue to improve the quality of subsequent reports. As of January 31, 2003, all banks were using the New Call Report and only minor, easily corrected mistakes were being made.

Supervisory Tools Related to Off-site Supervision

After the completion of the Off-site Surveillance Course (see Section G, Training for further discussion), USAID advisors began to conduct on-the-job training for the off-site staff to reinforce the newly acquired concepts of the CAEL analysis and risk ranking methodology. Initially, staff efforts focused on the review of financial returns for correctness and integrity of reporting, and the identification of reporting errors. The next step included communication with the banks and correction of the data because a valid CAEL analysis can only be performed using an accurate regulatory database.

Simultaneously, USAID advisors designed a spreadsheet containing about seventy ratios and values, and taught the off-site staff how to analyze the information. The spreadsheet contains ratios for several quarters that are useful for trend analysis. This spreadsheet and several other supporting reports constitute the basis for quarterly analysis and rating each bank's capital, assets, earnings and liquidity.

Each analyst is required to update the spreadsheet with financial information as of the last quarter, review the information for completeness, internal cohesion and consistency with other reports, and obtain from the bank explanations and/or corrections of the data that are either unusual or incorrect. Afterwards, each analyst prepares a written report containing the results of quarterly off-site analysis according to the CAEL methodology.

The report is divided into four sections, discussing capital, asset quality and composition, earnings, and liquidity. Each section is supposed to address the present condition, historical trends and make predictions about future trends. Based on the review of this information, analysts rate each component on a scale from 1 to 5 with a rating of 1 being the lowest level of risk.

In the second quarter of 2001, the off-site unit began to incorporate audited banks' statements into the overall analysis. USAID advisors designed another spreadsheet to facilitate this comparison and focused on-the-job training for the off-site staff on identification, reconciliation and correcting the differences between the audited statements and financial data in the PMA database. In addition, the PMA staff communicated the results of this analysis to the banks and external auditors, asked for an explanation of differences and correction of data submitted to the PMA.

This process has been very beneficial not only in terms of disciplining the banks and increasing transparency in the financial system, but also as an educational tool for analysts and examiners to learn how to identify errors and communicate with banks necessary corrective action. It is also helpful in terms of analyzing and interpreting the external auditors' reports.

At the end of the first quarter of 2002, the off-site staff conducted between two to three quarterly CAEL analyses for each of the nine banks assigned to the Ramallah off-site staff.

D. LEGAL AND REGULATORY

Because the PMA must work within a complicated legal and regulatory framework, many initiatives in this area focused on clarification of concepts and establishment of a regulatory regime following international and IMF guidelines. Initially, USAID advisors reviewed the draft "Banking Law". This review culminated with a detailed written analysis of the draft document with comments endorsing improvements to better support bank supervision functions. Additionally, USAID advisors worked closely with PMA management to develop remedies for problem banks under the existing legislation in the West Bank and Gaza. Advisors prepared a legal review of current legal documents and provided a discussion paper.

During the development of the Report of Condition and Income, it became apparent that a comprehensive review of all PMA regulations and circulars was necessary in order to ensure appropriate tracking of compliance. USAID advisors recommended the establishment of a regulatory review committee to review the existing regulations, to harmonize them with the proposed new laws and to identify areas where new rules and regulations were required to support changes in the banking industry. The Governor approved the recommendation and at the end of 1999, a newly formed committee conducted a comprehensive regulatory review and supported the off-site methodology development team in solving legal and regulatory issues.

The committee, with guidance from USAID advisors, completed regulations concerning Provision and Collateral for Facilities, Credit Concentrations and Investments in Securities, Capital Adequacy Ratios and Minimal Capital Requirements, Open Currency positions, Liquidity Requirements, and Investment Securities and Bank Dealer Activities. A definition of a 'resident' was prepared according to IMF requirements. In addition, the team reviewed the most recent draft of the Banking Law to ensure that all the new regulations complied with its articles.

Other initiatives taken by USAID advisors included the following:

- Redrafted portions of the draft Banking Law, specifically pertaining to prohibited transactions and a definition of commercial interests. This definition was necessary for the design and instructions to the Call Report when capturing an affiliated person's (insider) borrowing and deposit data.
- Clarified certain points concerning the legal lending limit. The Ramallah examiners calculate the limit for foreign branches based on the capital of the consolidated parent organization, while Gaza examiners calculate the limit based on the 'donation capital' that foreign branches are required to hold in Palestine, currently US\$5 million.
- Initiated new regulations covering loss loans' classification, provisions, admissible collateral, balance sheet valuation, capital adequacy and concentration limits.
- Worked closely with IMF consultants to recommend changes to content and format of draft regulations to bring them in line with IMF standards.
- Assisted in the development of a specific regulation on Provisions and Collateral for Facilities for Islamic Banks.

Additionally, in July 2001 USAID advisors provided input to a revised regulation on Asset Classification, Provisioning and Admissible Collateral. PMA issued the new regulation as Circular # 93 – D4/7/2001 in July 2001. The new regulation is a notable improvement and includes: the standardization of the classification approach; the definition and quantification of admissible collateral; and the introduction of the economic condition of the borrower as one of the criteria for asset classification. The change to reviewing the economic condition of a borrower allows for a more proactive classification and provisioning than a mechanism relying solely on an asset's past due status. The new regulation conforms to the Basel Core Principles and

international regulatory practice. Further revisions to the Circular # 93 are being considered. These revisions will address collateral protection adequacy and how it is used in calculating provision requirements.

E. PROBLEM BANK SUPERVISION

Meaningful Problem Bank Supervision poses difficulties to the PMA because of the political and economic environment, and the influence of foreign banks on the Palestinian banking system. However, in October 1999, USAID advisors reviewed information on three potential problem banks and developed action plans for dealing with key weaknesses facing these institutions.

USAID advisors delivered a problem bank workshop in both Ramallah and Gaza offices using the three banks as case studies. USAID advisors provided a draft Problem Bank Manual that needed to be incorporated into a pilot problem bank program in order to test for applicability to the Palestinian legal framework and banking environment. To date, such a pilot program is on hold until appropriate changes in the political and economic environment becomes conducive to more effective supervision of problem banks.

However, in mid 2001 the PMA took strong administrative action against an extremely financially weak and poorly managed bank, and placed the institution into receivership. USAID advisors supported the receiver by conducting analysis of the bank's financial data, analyzing audited statements and discussing possible actions that could be taken by the receiver in order to improve the bank's condition. The actions taken by PMA in this instance indicate a willingness to pursue appropriate action towards problem banks, but only under extreme conditions.

F. LICENSING

While licensing activity within the Palestinian territory has been limited, USAID advisors conducted a thorough review of PMA licensing practices. During October 1999, USAID advisors developed a comprehensive bank license approval package. This package provides for more detailed information regarding potential banks' founders along with the managing board and bank administrators. USAID advisors also developed a document-processing checklist to ensure that all pertinent documents relating to the bank's application are checked when received. Additional guidance was provided on the treatment of Money Changers under the bank regulatory processes in the West Bank and Gaza. These tools are now available to the PMA in reviewing new licensing applications.

G. TRAINING

This section highlights the training courses and delivery dates, presented by resident and short-term advisors during this Project.

Basic Bank Supervision:

During the second quarter of 1999, a resident advisor on-site delivered the Basic Bank Supervision course for examiners and analysts. The course provided a basic overview of Bank Supervisory Activities from the regulatory perspective. The major topics included: bank supervision – definition and policy, the supervision function and process, legal and regulatory matters and the condition of the institution – risk analysis within the institution. During the third quarter of 2003, the senior consultant delivered this course to 12 newly hired staff members.

Basic Credit Analysis:

In July 1999, a short-term advisor delivered the Basic Credit Analysis course for examiners and analysts. The course provided the Basic Tenants of Sound Credit Generation and the Management of Risk in the Lending Operation. Students were introduced to the Importance of Operational, Managerial, and Audit Controls in the credit generation and management processes. The course illustrated typical loan grading systems utilized by banking institutions. Finally, students gained an appreciation for the root causes of unsatisfactory loan portfolios.

New Employees Training Program:

During March, April and May 2000, resident and short-term advisors delivered a comprehensive training program to 12 newly hired PMA employees. A similar program was designed and delivered during the September and October 2003. The participants and the PMA considered the training as very successful and consequently the new employees were easily integrated into the supervision department. The following ten one-week courses were presented to the PMA staff during this training:

Basic Bank Supervision:

In March 2000, a resident advisor delivered the Introduction to Bank Supervision course. The course provided a basic overview of Bank Supervisory Activities from the regulatory perspective.

Bank Accounting for Examiners:

In March 2000, a resident advisor delivered the Bank Accounting for Examiners course. The course provided explanation of International Accounting Standards as they apply to the banking industry, introduced accounting theory within the context of bank supervision, and related financial statements to customer base, investor reports and regulatory reporting.

Islamic Banking:

In April 2000, a senior member of the PMA staff with assistance from USAID advisors delivered the Islamic Banking course. The course focused on major differences between commercial and Islamic banking, issues pertinent to prudential regulations and supervision of Islamic banks, and accounting standards for Islamic banks. The course examined the difficulties and benefits of Islamic banks operating in a conventional banking system.

Off-site Supervisory Techniques:

In April 2000, a resident advisor delivered the Off-site Supervision Techniques course. The course introduced the off-site supervisory process, its integration into the supervisory strategy and its complementary role for on-site supervision.

Internal/External Audit:

In April 2000, a resident advisor delivered the Internal/External Audit course. The course focused on the introduction of the role of internal controls in risk management, understanding and appreciation the importance of internal controls and audit procedures, and the effectiveness of internal controls.

Basic Funds Management:

In May 2000, a resident advisor delivered the Basic Fund Management course. The course provided a review and evaluation of banking risks and necessary control procedures, developed an understanding of existing theories of funds management, related the issues to real life examples and developed appreciation for control features.

Basic Credit Analysis:

In May 2000, a short-term advisor delivered the Basic Credit Analysis course. The course provided the basic tenants of sound credit generation and management of risk in the lending operation.

Capital Markets (Treasury, Dealing, Foreign Exchange):

In May 2000, a short-term advisor delivered the Capital Markets course. The course provided an overview of Capital and Foreign Exchange Markets, and Dealer activities.

Managing the Examination Process:

In May 2000, a resident advisor delivered the Managing the Examination Process course. The course provided a review of the objectives of supervision (continuous, efficient, effective, risk-based and guided by the strategy), new concepts in managing the examination, delegation of duties and authority, personnel management and the importance of effective communication.

Practical Bank Simulation and Cases:

In June 2000, resident advisors led the Practical Bank Simulation and Cases seminar. This section of the training provided an opportunity for the participants to put into practice all the recently acquired knowledge.

Off-site Supervisory Techniques:

In June 2000, a resident advisor delivered a two-week Off-site Supervision Techniques course for the all analysts and examiners except the newly hired staff. The course introduced the off-site supervisory process, its integration into the supervisory strategy and its complementary role for on-site supervision. In February 2002, a resident advisor delivered a two-week Off-site Supervision Techniques course for newly hired off-site analysts.

H. FINANCIAL INTELLIGENCE UNIT

During December 2002 two short-term advisors were on-site at the PMA to conduct initial reviews of the required actions to create a Financial Intelligence Unit (FIU). During these visits and meetings with counterparts the advisors completed the following:

- Developed a general strategy for the development of the FIU, including staffing needs and the basic requirements of an FIU database. An outline of this general strategy was developed which included proposed dates and deliverables for future technical assistance visits to the PMA.
- Worked on job descriptions and an outline of responsibilities for members of the FIU.
- Identified the following major issues as problem areas:
 - 1) Differing opinions regarding responsibilities and placement of the FIU within the PMA.
 - 2) Limited expertise regarding money laundering issues.
 - 3) No current administrative infrastructure regarding money laundering issues.
 - 4) Lack of a clear vision of how to structure the FIU.

Delivery of follow-on assistance has been repeatedly postponed by the PMA. Beyond those deployment efforts postponed as noted in project quarterly reports, during the last four months of the project efforts were expended by BearingPoint to bring an FIU expert and FIU IT specialist to the PMA. These trips were cancelled at the request of PMA Governor Haddad. The most recent event scheduled by BearingPoint, but then abruptly cancelled at the request of the PMA, was a planned trip by PMA Governor Haddad to visit established and operating FIUs in the Netherlands and Belgium. All arrangements had been made to visit these two FIUs and additional efforts were in process to add a visit to the FIU in France when the visits were cancelled.

III. PROGRESS RELATIVE TO BENCHMARKS

Despite the addition of the FIU components, no benchmarks have been added to the task order since the initial contract of September 1998.

Technical compliance has been achieved on ten (10) of the eleven (11) benchmarks.

Benchmarks

- A) A policy proposal for dealing with cross-border supervisory issues should be presented to the Governor of the PMA within two quarters from the beginning of the contract. By the end of the first year evidence should be presented that policy & procedures for handling this issue are in place and being executed.***

This benchmark has been technically met.

Initial work on the cross-border policy began in May 1999 when a senior policy advisor worked to identify the weaknesses in the current Cross-Border Agreements with the countries of Jordan, Egypt and Tunisia. The draft Agreement was presented to Governor Foad Beseiso on July 19, 1999 and later approved, verbally by Dr. Beseiso, on August 17, 1999. As of this report, the Cross-Border Agreement has not been negotiated or implemented with other central banks having banking activities in the West Bank/Gaza.

Full compliance with this benchmark depends upon the willingness and cooperation of the other countries. The PMA has a policy that addresses cross-border cooperation with home country supervisors.

B) By the end of the first year the BSD should have a strategy statement and within eighteen months there should be clear evidence that this strategy is being translated into day-to-day operations.

This benchmark has been met, both within the initial eighteen months timeframe and on going.

Each year the PMA has adopted an operating strategy for the BSD. The department's Strategic Operating Plan for 2003 has been drafted and distributed to senior PMA managers and department managers.

As with past strategies, the 2003 plan deals with specific targets; i.e., encouragement of bank/branch mergers; improved communication with external auditors; improved internal communications through enhancement of the PMA's Supervisory Files; adoption and implementation of a Problem Bank Resolution Program; and, BSD staffing and restructuring. The USAID resident advisor played a key role in drafting the 2003 Strategy. He reviewed initial department drafts and then proposed expansion and clarification in many areas. His suggestions produced a document that was forward looking and did not itemize past accomplishments. His proposal also eliminated what were really job descriptions and instead listed clearly defined goals and objectives.

C) Within two quarters a bank examination schedule should be prepared as well as preliminary versions of standardized documents relating to onsite examination such as report of examinations, request letters to banks and formatted working papers. By the end of the first year, evidence should be presented that examinations are being conducted according to a pre-determined schedule and standardized documents are being routinely employed.

This benchmark has been technically met.

Since 1999, a bank examination schedule has been prepared and followed – exceptions to the schedule have been the result of the restrictions imposed on the movement of PMA inspectors as a result of the occupation of the West Bank & Gaza by Israeli military troops and the restrictions of movement by Palestinians within the occupied territories.

Barents advisors have prepared and presented to the BSD – in Arabic - a handbook (manual) of standardized examination procedures which covers the following areas: *Planning and Control; Internal and External Audits; Review of Regulatory Reports; Analytical Review of Income and Expense (Earnings); Capital Accounts and Dividends; Deposit Accounts; Commercial Loans; Letters of Credit; Guaranties Issued; Funds Management (Asset-Liability Management); Management and Board Processes, Foreign Exchange; Real Estate Loans; Loan Portfolio Management; Related Organizations; and, Overall Conclusions Regarding the Condition of the Bank.*

With these chapters, the PMA bank supervision department has the tools to conduct onsite bank examinations under an international approach using the CAMELS rating system. It should be noted that the process to use these procedures must be supported and enhanced by the use of scheduled classroom training courses.

In addition, the advisors presented the PMA with a standardized examination report and a document on CAMELS ratings. The document outlines the CAMELS ratings process and provides extensive definitions of each of the CAMELS components and of the composite rating. A training program was conducted in the third quarter of 2000 for examiners-in-charge in Ramallah, specifically focusing on how these processes can be used in West Bank/Gaza. The training was underway at the start of the civil unrest and was interrupted for several months. Training resumed in the first quarter of 2001.

During the first quarter of 2002, supervision staff developed and began to implement the Supervisory File. The Supervisory File is a computer based data file for each bank. The file contains corporate and risk assessment information, including summaries of onsite inspections and offsite analysis, correspondence, and supervisory action plans for each bank. The action plans are the basis for a formalized scheduling process. Bank supervision, working with the IT department, developed the Supervisory File format and parameters.

D) The supervisory action plans developed for each bank are the basis for a formalized scheduling process for onsite activities. We initially started with the onsite action plans and designed an automated scheduling process that will allow management to provide sufficient resources to onsite activities. The scheduling process involves prioritizing activities based on banks' risk profiles, time since the last examination, and available resources. By the end of the first year the BSD should be able to conduct a full scope examination.

This benchmark has been technically met.

BSD examiners are conducting full scope examinations, as well as frequent targeted examinations. However, resident advisors are not participating in onsite examinations. In the past, this was because bank supervision management in Ramallah and Gaza were prohibiting such participation until the PMA Board and Acting Governor Haddad approved. This approval has been given; however, the sole resident advisor was required to be in the PMA assisting with managerial issues and

unable to be out of the PMA for the extended periods required to participate in an on-site examination.

E) By the end of six months a preliminary plan for rationalization of a Call Report should be presented which should be adopted by the end of the first year of the contract. By the end of the first year of the contract at least a rudimentary early warning system should be in place with summary management reports for senior management. By the end of the first year a draft offsite policy and procedures manual should be in place.

This benchmark has been technically met.

The new Report of Condition and Income, including schedules and line item instructions, has been completed and released to the banks. Banks reviewed these reports and the PMA, in conjunction with Barents Group advisors, conducted consultation sessions with the banks to promote timely and accurate submission of financial data. PMA staff is monitoring banks' progress and supporting their effort as necessary. As of the end of January 2003, there was 100% compliance with the filing requirements. While errors were identified in submitted reports, these were minor in nature and easily corrected.

In addition, the PMA facilitated the development of electronic links connecting banks' headquarters with their branches, which will enhance speed and accuracy of financial data gathering by the banks.

Programming instructions for the Uniform Bank Performance Report (UBPR), an integral part of the early warning system, have been completed and submitted to the PMA's Information Technology Department. Presently, the Information Technology Department is designing an Oracle database that will capture data submitted by the banks and generate the UBPR.

As part of Supervisory File and Supervisory Action Plan, the offsite scheduling process was developed. The offsite scheduling process incorporates routine activities, e.g. monthly reviews and quarterly CAEL analysis, and will also coordinate activities with the onsite area in order to begin to introduce an integrated supervisory approach.

F) By the end of six months, work should have begun on a pilot program for problem bank resolution.

This benchmark has been technically met.

An advisor presented the PMA with a draft program for problem bank resolution in October 1999. Considering the level of problems with the banks at the time, focus of the PMA bank supervision department was directed toward examination scheduling and the development of sound examination procedures.

During the second quarter of 2003, the resident advisor has drafted a Corrective Action Program for dealing with problem banks. The draft, which was distributed to the department, provides for consistent application of corrective actions.

G) By the end of the first year a draft policy and procedures manual for problem bank resolution should be prepared.

This benchmark has been technically met.

As noted above, a draft policy and procedures for problem bank resolution were delivered to the PMA. The originally drafted problem bank resolution documents have been reviewed and a draft program for dealing with problem banks has been prepared and presented to the PMA. Implementation of the program will follow the PMA's review and discussions. Once this occurs, the program should be tested for applicability to the Palestinian legal framework and banking environment.

H) By the end of the first year recommendations should be prepared regarding policies and procedures for evaluating licensing applications.

This benchmark has been technically met.

During October 1999, a licensing expert continued efforts started earlier in the contract. The advisor developed a comprehensive bank license approval package. This package provides for more detailed information regarding the potential bank's founders along with the managing board and bank administrators. The advisor also developed a document-processing checklist to ensure that all pertinent documents relating to the bank's application are checked when received. The advisor provided guidance on the treatment of Money Changers under the bank regulatory processes in the West Bank/Gaza. These policies and procedures remain outstanding items with regard to follow-up by the PMA.

I) By the end of the first year an outreach program to improve communication with the commercial banks should be in draft form.

This benchmark has not been technically met.

The reluctance of PMA senior management to go forward in this area was the major impediment to meeting this benchmark. Meetings are now being held with the bankers and the PMA is represented on the Association of Palestinian Bankers (the bankers' association.) A true "outreach program" has not been developed and while discussions of such are held from time-to-time, meetings are held on an as-needed basis and are for specific, pressing issues at the time. Although no formal outreach program is in place, the PMA has begun to consult with banks on issues such as new regulations, regulatory reporting, management information systems, and information technology, and has included Barents Group advisors in these consultations

J) By the end of the first six months an evaluation should be made on the deficiencies in the regulatory structure. By the end of the first year drafts of

changes to the regulatory structure should be prepared for discussion with counterparts.

This benchmark has been technically met.

Work on this benchmark was initially deferred pending the approval by PMA senior management of the overall Strategic Plan submitted by the Barents Group Senior Policy Advisor. Draft regulations were subsequently developed in August and September 2000 covering Provisions and Collateral for Facilities, Credit Concentrations and Investment in Securities, Capital Adequacy Ratio and Minimum Capital Requirements, Open Currency Positions, Liquidity Requirements, and Investment Securities and Bank Dealer Activities. In addition, a definition of 'resident' was prepared according to IMF requirements. The draft regulations were compared against the draft of the Palestinian Banking Law to ensure that they complied with its articles.

K) Within three months, a draft integrated bank supervision training program should be prepared for approval by the PMA. By the end of six months at least monthly classes should be in place.

The requirements of this benchmark have been technically met.

Comprehensive training programs were developed for new hires during the first and second quarters of 2000 and during the second quarter of 2003. In addition, several ad hoc training sessions have been conducted throughout the project on an as needed basis.

IV. IMPEDIMENTS TO PROGRESS (Bottlenecks to Further Progress)

The major and significant obstacle to ongoing technical assistance being provided to the PMA is the inability of all concerned – PMA, bank managers, USAID officials, and USAID advisors – to move freely within the West Bank / Gaza and to travel to and from these areas. No relief from these restrictions is anticipated over the short-term.

V. PROJECT SEQUENCING

The effective delivery of technical assistance requires both quality and quantity of providers. The FIU portion of the program was continually challenged by the inability to deploy advisors because of the reluctance of the counterpart to host them. Because of this, Barents (BearingPoint) was unable to meet expectations with regard to establishing the FIU. In addition, efforts to provide assistance regarding central bank management were also cancelled by the counterpart.

VI. ADDITIONAL TASKS DELIVERED

Throughout the last year of this contract, the senior consultant provided the bank supervision department with strong managerial assistance. During this time period,

the existing director was replaced by an outside hire who required close, hands-on assistance.

The senior consultant, at the specific request of Governor Haddad, lead a team of senior PMA officials in the development of a survey to capture prudential banking supervision practices from some fifty (50) countries. He also designed a comprehensive written and oral examination that was presented to all members of the department. The examination was designed to gauge the general knowledge level of all department employees. The examination scores will also be used as part of the department's promotion program.

All during his time with the department, the senior consultant provided guidance and council in the area of personnel management. He assisted in the interview process for over 50 candidates; he discussed employee motivational techniques; and he participated in PMA senior management meetings – providing in-put on a wide variety of managerial issues.

During the final months of the project, the PMA Governor requested assistance from an advisor experienced in central bank management, structure and procedures, including experience in central bank administration. The proposed scope of work for this advisor would have been reviewing and revising (as needed) the PMA's Bylaws, as well as developing operational manuals for each of the departments - except the bank supervision department which already has an operational manual. BearingPoint proposed an advisor, but the PMA governor cancelled the proposed trip.

VII. ROLE OF THE COUNTERPART

Throughout the program, bank supervision department staff was receptive to all technical assistance provided on-the-ground. There was a change of leadership at the PMA during the period of the program and there were four changes in senior department management. Each of these changes brought new counterpart personalities for the advisor team. The advisors were successful in meeting these challenges.

VIII. ROLE OF OTHER DONOR ORGANIZATIONS

The resident advisor met with representatives from the US Treasury Department's Office of Technical Assistance during December 2002 during their brief visit to the PMA. The representatives expressed an interest in providing technical assistance in a number of areas, but no definitive commitments were made at that time, or since.

IX. PROBLEMS STILL TO BE ADDRESSED

The banking supervision function of the PMA has improved significantly over the past four and one-half years. The Banking Law is now adopted and implementing regulations (in the form of circulars) have been adopted. A strong management team is now in place and training of staff continues.

However, bank supervision remains very fundamental – emphasis continues to focus on compliance as opposed to risk management capacity of bankers. In general, banks operating under the authority of the PMA are sound. Because of this, the PMA has

time to further develop its overall supervisory capacity with little fear of a bank failure or major systemic problems. Banks are suffering loan quality problems; however, provisioning requirements have resulted in sufficient reserve levels being maintained.

The problems facing the PMA in the area of bank supervision are:

- A. Organizational: The desirability of having the Licensing Unit in Gaza; the development of a Consumer Complaint Unit.
- B. On-site supervision: Further development of the examining staff in the ability to analysis bank financial data and operational practices and then present a meaningful summary of their findings – highlighting their conclusions and recommendations.
- C. Off-site supervision: The unit has the tools necessary to do their job, however, they lack the skill to perform true analyses of data reviewed.
- D. Problem Bank Resolution: The PMA has not adopted a standardized format for dealing with problem banks.
- E. Financial Intelligence Unit: The PMA has not gone forward with this critical element of banking supervision – from a legal framework perspective, a data gathering standpoint or an enforcement aspect.

X. SUGGESTIONS WHERE FURTHER TECHNICAL ASSISTANCE COULD BE DELIVERED

Further technical assistance could be delivered in the following areas:

Organizational Structure:

- A. Assessment of organizational structure with emphasis on the desirability of having the Licensing Unit in Gaza.
- B. Assessment of the feasibility of developing a Consumer Complaint Unit.

On-site Supervision:

- A. Providing on-the-job (OJT) training during on-site examinations.
- B. Development of standardized Report of Examination (ROE) comments.
- C. Development and implementation of an examiner certification program.
- D. Development and implementation of examination procedures for money changers.
- E. Implementation of a CAMEL Rating Matrix.

Off-site Supervision:

- A. Assist in the development of meaningful analysis comments.
- B. Review and modify the Early Warning System.

Problem Bank Resolution:

- A. Review, modify (as needed), and implement standardized policy and program.
- B. Identify and train a team of examiners to deal with these types of institutions.

Training:

- A. Conduct formal classroom training sessions as given in the past for new employees.
- B. Provide formal training in the areas of funds management; investments; effective communications (both oral and written); IT examination practices; and, operational and market risk management.
- C. Provide US-based training opportunities – Federal Reserve Bank internships.
- D. Facilitate inter-regional training opportunities

Outreach:

- A. Development and deliver outreach programs for bankers, the general public, external auditors, the financial press, the PLC and the Office of the Prime Minister.

Financial Intelligence Unit: (Given the counterpart's non-acceptance of assistance offered during the last year, the PMA was be fully aware of the expectations of them and then their commitment to adhere to those expectations must be obtained.)

- A. Codification of a legal framework to establish an FIU in keeping with advisor recommendations.
- B. Establishment of an FIU within the PMA.
- C. Development of an IT infrastructure to track financial data necessary for enforcement of anti-money laundering provisions.
- D. Off-site training, either third country or U.S.-based, for members of the FIU to more thoroughly understand the operations of an operating FIU.

Other Issues:

- A. Assistance was requested by the counterpart, at the conclusion of the task order, in the following areas:
 - Central bank operations procedures.
 - Mergers of commercial banks.

- B. Assess the feasibility of developing a regional Bankers' Training Center
- C. Review and update PMA Administration Department Policies & Manuals
- D. Assess the adequacy of the PMA's internal audit operations
- E. Provide training to the PMA's Research Department
- F. Review and update the policies & practices of the Clearing House Department
- G. Review and update the policies & practices of the Legal Department
- H. Review and update the policies & practices of the PMA advisors to the Governor and the Governor's Office
- I. Assist the Bankers' Training Center (which is part of the PMA) in the development of a core set of classes to be offered on a regular basis to both PMA staff and bank staff
- J. Assist the Bankers' Association in becoming a viable and constructive lobbying and education unit for the banking industry
- K. Facilitate the development of working groups within the Bankers' Association in a variety of banking areas – credit risk analysis, customer service, capital adequacy, funds management, etc.

ATTACHMENTS

- A. March 16, 1999 Diagnostic Report
- B. 1999 – 2001 Strategy
- C. 2003 Operating Plan (Strategy)
- D. Off-site Supervision Manual
- E. Draft Banking Law
- F. Draft PMA Law
- G. Report & Recommendations for Dealing with Problem Banks (9/99)
- H. Proposed Corrective Action Program (4/03)
- I. Training Needs Assessment (2/03)
- J. Proposed Training Schedule (6/03)
- K. CD-ROM containing Arabic and English versions of the following:
 - 1) Call Report – forms and instructions
 - 2) On-Site Manual
 - 3) Operation Manual
 - 4) Training Courses –
 - a) Basic Bank Supervision
 - b) Introduction to Credit Risk
 - c) Off-Site Supervision
 - d) IT for Examiners
 - e) Audit and Control
 - f) Funds Management
 - g) Examination Management
 - h) Accounting for Examiners
 - i) Introduction to the Call Report